



[6705-01-P]

FARM CREDIT ADMINISTRATION

12 CFR Parts 614, 615, 620 and 628

RIN 3052-AD27

Regulatory Capital Rules: Tier 1/Tier 2 Framework

AGENCY: Farm Credit Administration.

ACTION: Proposed rule.

SUMMARY: The Farm Credit Administration (FCA or we) seeks comments on this proposed rule that would amend regulatory capital requirements for Farm Credit System (System) institutions and clarify certain provisions in the Tier 1/Tier 2 Framework final rule that became effective in 2017. This proposed rule would incorporate, and further clarify, the guidance provided in FCA Bookletter - BL-068 - Tier 1/Tier 2 Capital Framework Guidance. The proposal would also eliminate regulatory capital requirements for the Farm Credit Services Leasing Corporation, simplify the Safe Harbor Deemed Prior Approval calculation, revise the board resolution requirement for certain equities to be included in tier 1 or tier 2 capital, and amend the lending and leasing limit base to use total capital instead of permanent capital and eliminate the exceptional treatment of certain purchased stock. To

maintain comparability in our regulatory capital requirements, we propose to amend certain definitions pertaining to qualified financial contracts in conformity with changes adopted by the Federal banking regulatory agencies.

DATES: Please send us your comments on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: For accuracy and efficiency reasons, please submit comments by e-mail or through FCA's website. We do not accept comments submitted by facsimile (fax), as faxes are difficult for us to process in compliance with section 508 of the Rehabilitation Act of 1973. Please do not submit your comment multiple times via different methods. You may submit comments by any of the following methods:

- E-mail: Send us an e-mail at reg-comm@fca.gov.
- FCA Web site: <http://www.fca.gov>. Click inside the "I want to..." field near the top of the page; select "comment on a pending regulation" from the dropdown menu; and click "Go." This takes you to an electronic public comment form.
- Mail: Jeremy R. Edelstein, Associate Director, Office of Regulatory Policy, Farm Credit

Administration, 1501 Farm Credit Drive, McLean, VA
22102-5090.

You may review copies of all comments we receive at our office in McLean, Virginia or on our Web site at <http://www.fca.gov>. Once you are on the Web site, click inside the "I want to..." field near the top of the page; select "find comments on a pending regulation" from the dropdown menu; and click "Go." This will take you to the Comment Letters page where you can select the regulation for which you would like to read the public comments.

We will show your comments as submitted, including any supporting data provided, but for technical reasons we may omit items such as logos and special characters. Identifying information that you provide, such as phone numbers and addresses, will be publicly available. However, we will attempt to remove e-mail addresses to help reduce Internet spam.

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I. Introduction

A. Objectives of Proposed Rule

The FCA's objectives in proposing this rule are to:

- Provide technical corrections, amendments and clarification to certain provisions in the Tier 1/Tier 2 Capital Framework; and
- Ensure the System's capital requirements maintain comparability with the standardized approach that the Federal banking regulatory agencies have adopted.

B. Background

In 1916, Congress created the System to provide permanent, stable, affordable, and reliable sources of credit and related services to American agricultural and aquatic producers.¹ The System consists of 3 Farm Credit Banks, 1 agricultural credit bank, 67 agricultural credit associations, 1 Federal land credit association, service corporations, and the Federal Farm Credit Banks Funding Corporation (Funding Corporation). Farm Credit banks (which include both the Farm Credit

¹ The Federal Agricultural Mortgage Corporation (Farmer Mac), which is also a System institution, has authority to operate secondary markets for agricultural real estate mortgage loans, rural housing mortgage loans, and rural utility cooperative loans. The FCA has a separate set of capital regulations that apply to Farmer Mac. This rulemaking does not affect Farmer Mac, and the use of the term "System institution" in this preamble and proposed rule does not include Farmer Mac.

Banks and the agricultural credit bank) issue System-wide consolidated debt obligations in the capital markets through the Funding Corporation, which enable associations to provide short-, intermediate-, and long-term credit and related services to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and farm-related service businesses.² The System's enabling statute is the Farm Credit Act of 1971, as amended (Act).³

FCA's Tier 1/Tier 2 Capital Framework final regulation (Capital Rule) was published in the *Federal Register* in July 2016.⁴ The objectives of the Capital Rule were:

- To modernize capital requirements while ensuring that institutions continue to hold enough regulatory capital to fulfill their mission as a Government-sponsored enterprise (GSE);

² The agricultural credit bank lends to, and provides other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural water and waste water disposal systems. It also finances U.S. agricultural exports and imports, and provides international banking services to cooperatives and other eligible borrowers. The agricultural credit bank operates a Farm Credit Bank subsidiary.

³ 12 U.S.C. 2001-2279cc. The Act is available at www.fca.gov under "Laws and regulations," and "Statutes."

⁴ 81 FR 49720 (July 28, 2016).

- To ensure that the System's capital requirements are comparable to the Basel III framework and the standardized approach that the Federal banking regulatory agencies have adopted, but also to ensure that the rules take into account the cooperative structure and the organization of the System;
- To make System regulatory capital requirements more transparent; and
- To meet the requirements of section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).⁵

To date, the FCA believes the Capital Rule has met, and continues to meet, these stated objectives.⁶

On December 22, 2016, the FCA Board adopted FCA Bookletter - BL-068 - Tier 1/Tier 2 Capital Framework Guidance (Capital BL).⁷ The Capital BL provided additional guidance to ensure System institutions had the necessary information to correctly implement the requirements of the Capital Rule. The Capital BL

⁵ Public Law 111-203, 124 Stat. 1376 (2010).

⁶ For a more comprehensive discussion of this rulemaking, including a comprehensive discussion of all System capital requirements, see 81 FR 49720 and Parts 615 and 628 of FCA Regulations.

⁷ A copy of the Capital BL can be found at www.fca.gov, under "Laws & Regulations" and "Bookletters."

included clarification and technical fixes on 18 separate items. Furthermore, the Capital BL stated: "We intend to incorporate some of these items into the regulation in a future rulemaking project."⁸ This proposed rule would incorporate some of that guidance, with adjustments as discussed below,⁹ into the capital regulation. Additionally, the proposed rule would:

- Eliminate the stand alone capital requirements for Farm Credit Leasing Services Corporation (Farm Credit Leasing);
- Change the computation of the lending and leasing limit base in § 614.4351, by using total capital instead of permanent capital in the calculation;¹⁰
- Simplify "Safe Harbor" provisions that determine when System institutions have "deemed prior approval" from FCA to distribute cash payments;
- Revise and clarify certain criteria that capital instruments must meet to be included in common equity tier 1 (CET1) and tier 2 capital;

⁸ Id.

⁹ FCA made adjustments to some of the guidance provided in the Capital BL to address concerns identified through ongoing monitoring and examination of the requirements of the Capital Rule.

¹⁰ Total capital is defined at § 628.2. Permanent capital is defined at § 615.5201.

- Provide further clarification on when the “holding period” starts for including certain Common Cooperative Equities in CET1 or tier 2 capital; and
- Amend the requirement to adopt an annual board resolution with respect to prior approval requirements and the minimum redemption and revolvment periods for certain equities included in CET1 or tier 2 capital.

Finally, we propose to amend the definitions of “Collateral agreement,” “Eligible margin loan,” “Qualifying master netting agreement (QMNA),” and “Repo-style transaction” to incorporate amendments made to these definitions in the capital rules of the Federal banking regulatory agencies.¹¹

The above amendments, as well as technical changes and other guidance on FCA’s expectations for certain provisions of the Capital Rule, are described in greater detail below. FCA believes the additional proposed changes will address issues and concerns identified since the Capital Rule’s effective date of

¹¹ The Federal banking regulatory agencies are the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC).

January 1, 2017, while maintaining and supporting the objectives of the Capital Rule.

We welcome comments on every aspect of this proposed regulation, but there are certain areas described below where we are specifically seeking comment.

II. Proposed Revisions to the Capital Rule

A. Substantive Revisions to the Capital Rule

The amendments to the Capital Rule proposed and discussed in this section are substantive issues that go beyond technical corrections or incorporation of issues discussed in the Capital BL.

1. Safe Harbor Deemed Prior Approval

The proposal amends the "Safe Harbor Deemed Prior Approval" provisions under which System institutions are deemed to have prior approval from FCA to distribute cash payments as long as certain conditions are met. Existing § 628.20(f) requires System institutions to obtain prior approval from FCA before making any distributions of capital included in tier 1 or tier 2 capital.¹² Under the "safe harbor" provision in paragraphs (f)(5) and (6) of existing § 628.20, cash

¹² Section 628.20(f) outlines the requirements for FCA prior approval of capital redemptions and dividends.

dividends, cash patronage, and cash redemptions or revolvments of common cooperative equities are deemed to have FCA prior approval, provided that:

(i) The equities meet applicable minimum holding period requirements;

(ii) After such cash payments, the dollar amount of CET1 capital equals or exceeds the dollar amount of CET1 capital on the same date in the previous calendar year; and

(iii) The institution continues to comply with all regulatory capital requirements and supervisory or enforcement actions.

Under the existing "safe harbor," after the cash payment the dollar amount of CET1 capital must not decline compared to the dollar amount of CET1 capital on the same date in the previous calendar year.¹³ FCA considers the date of the cash payment to be the date on which the institution's board passes a binding resolution declaring an amount it will make as a cash dividend or patronage refund¹⁴ (declaration date). We consider this declaration date to be the date in

¹³ Section 628.20(f)(5)(ii).

¹⁴ This can either be a specified dollar amount or must include language whereby an amount could be calculated.

which the cash payment is made because it results in a binding legal obligation to pay a dividend or patronage refund to the institution's member-borrowers, the patronage amount is calculable within a short-time frame, and it is paid within 8.5 months of the close of the taxable year.

In practice, it is difficult for FCA to monitor and enforce the existing requirement to use the same date in the previous calendar year because System institutions report regulatory capital quarterly, not daily or monthly. Institutions can and do declare dividends or make patronage payments on any date during a calendar quarter. We propose to replace the requirement to use the exact calendar date on which the cash payment is made with a requirement to use the date of the quarter-end in which the System institution's board declares its dividend or patronage.

Under the proposal, a System institution has "deemed- prior approval" from FCA if, after making the cash payment, the dollar amount of the CET1 capital at the quarter-end after the declaration date, equals or exceeds the dollar amount of CET1 capital on the same quarter-end in the previous calendar year. The following is an example of our proposed deemed prior

approval: a System institution's board declares a cash patronage on December 16, 2020. To use the "Safe Harbor Deemed Prior Approval," the institution would need to ensure that after such payment, its dollar amount of CET1 capital on December 31, 2020, equals or exceeds the dollar amount of CET1 capital on December 31, 2019. As another example, a System institution's board declares a cash patronage on January 15, 2021. To use the "Safe Harbor Deemed Prior Approval," the institution would need to ensure that after such payment, its dollar amount of CET1 capital on March 31, 2021, equals or exceeds the dollar amount of CET1 capital on March 31, 2020.¹⁵ System institutions that declare patronage early in a quarter need to ensure that they have developed and implemented appropriate processes and controls to ensure compliance with these provisions.

We believe that this proposed amendment to the "Safe Harbor Deemed Prior Approval" would not increase

¹⁵ In both these examples, to use the "Safe Harbor Deemed Prior Approval," the System institution would also need to ensure that after such cash payment, it continues to comply with all regulatory capital requirements and supervisory or enforcement actions. These examples assume a cash patronage payment and not the redemption or revolvement of common cooperative equities (CCEs). CCEs must be held for the minimum required holding period described in § 628.20(f)(5)(i) for redemption to qualify for deemed prior approval under the "Safe Harbor."

or decrease the amount of cash patronage System institutions can pay when compared to the existing provision. As stated in the preamble to the final Tier 1/Tier 2 Capital Framework regulation, we expect institution boards to give significant thought to capital distribution decisions and how they impact the overall capitalization of their institution, especially a cash payment that exceeds net income over the past 12 months. Ordinarily, cash payments or redemptions (revolvments) are made at very predictable intervals, and we have not identified any situations where institutions are likely to need to make unplanned, significant capital distributions.¹⁶

2. Capital bylaw or board resolution to include equities in tier 1 and tier 2 capital

The proposal would amend the requirement in § 615.5200(d) that a System institution board adopt a redemption and revolvement resolution that it must reaffirm in its capital plan each year. It would also add a sentence to § 615.5200(b) with respect to capital adequacy plans.

¹⁶ See 81 FR 49735 (July 28, 2016).

Currently, to include otherwise eligible purchased or allocated equities in CET1 capital,¹⁷ a System institution must commit to obtaining prior approval from FCA under § 628.20(f) before redeeming or revolving the equities less than 7 years after issuance or allocation. For tier 2 purchased or allocated equities, the institution must make a commitment not to call, redeem, or revolve the equities less than 5 years after issuance or allocation without FCA approval. Finally, boards must commit to obtaining prior approval from FCA before taking other specified actions that could impact the institution's capital quantity or quality.¹⁸ A System institution's board must affirm these commitments by either adopting a capitalization bylaw or a resolution that must be re-affirmed by the board annually.

The proposal would move the existing requirements in § 615.5200(d) to a new section, § 628.21. Under

¹⁷ Otherwise eligible purchased or allocated equities would be equities that meet the criteria under § 628.20(b)(1) for inclusion in CET1 capital, such as allocated equities that will not be redeemed or revolved for at least 7 years.

¹⁸ Existing § 615.5200(d)(3) requires boards to obtain prior approval before redesignating unallocated retained earnings (URE) equivalents as redeemable equities; removing equities from regulatory capital (other than through repurchase, cancellation, redemption, or liquidation); or redesignating equities from one regulatory capital component to another. Section 615.5200(d)(4) requires that URE equivalents will not be revolved, except under very limited circumstances.

proposed § 628.21, a System institution's board must either adopt a capitalization bylaw or adopt a binding resolution to obtain the FCA prior approval that § 628.20(f) requires. Under the proposed rule, to reduce burden, an institution's board would no longer need to re-affirm this resolution annually; instead, the System institution would be required to expressly acknowledge the continuing and binding effect of these resolutions annually in their capital adequacy plan. Proposed § 615.5200(b) would add to the existing provisions a requirement that the capital adequacy plan must expressly acknowledge the continuing and binding effect of the board resolutions.¹⁹ Once the board adopts this resolution, it would remain binding going forward. Modifying or eliminating this binding resolution may impact an institution's ability to include allocated or purchased equities in tier 1 or tier 2 capital, if the change is not consistent with the requirements of proposed § 628.21 and § 628.20(b)(1)(xiv), (c)(1)(xiv), and (d)(1)(xi).

¹⁹ Specifically, § 615.5200(b) would be amended to require that the plan shall expressly acknowledge the continuing and binding effect of all board resolutions adopted in accordance with sections 628.20(b)(1)(xiv), 628.20(c)(1)(xiv), 628.20(d)(1)(xi), and 628.21. Conforming changes are being proposed to those sections to refer to new § 628.21 instead of § 615.5200(d).

The capital adequacy plan acknowledgment would, at a minimum, outline the existence of such a resolution and assure that any equities issued, allocated, redeemed or revolved shall be done so in accordance with the resolution. Consistent with the existing rule, any issuance or allocation of equities that a System institution intends to include in tier 1 or tier 2 capital, must be designated either CET1, AT1, or tier 2 at time of issuance or allocation.²⁰ We note that, in these proposed changes, our intent that institutions must establish the permanence of their regulatory capital designations is unchanged, but the means by which institutions do so should be less burdensome.

3. Common Cooperative Equity Issuance Date

The proposal adds a new definition to part 628 to provide clarification and certainty to System institutions on the start of the holding period to include certain common cooperative equities in CET1 or tier 2 capital and redeem them under the "Safe Harbor Deemed Prior Approval". Proposed § 628.21(e) states

²⁰ Under existing § 615.5200(d)(3)(iii), which is proposed to be redesignated as § 628.21(c)(3), a System institution cannot redesignate equities included in one component of regulatory capital for inclusion in another without FCA prior approval. Accordingly, the regulatory capital classification (i.e., CET1, AT1, or tier 2) must be designated at issuance.

that the minimum redemption and revolvment period for purchased and allocated equities starts on the common cooperative equity issuance date, as defined in § 628.2.

As discussed above, to include otherwise eligible purchased or allocated equities in CET1 or tier 2 capital, a System institution must commit to obtaining prior approval from FCA under § 628.20(f) before redeeming or revolving the equities in less than 7 or 5 years, respectively, after issuance or allocation. In December 2016, FCA provided guidance to the System on when the holding period starts for purchased and allocated equities, as follows:

The minimum holding period starts on the issuance date, which is the date the institution segregates its "new" allocated equities (qualified and nonqualified) from its URE. This generally occurs after the board adopts a resolution to make a patronage distribution in cash and equity, and the institution makes accounting entries that move the dollar amounts from URE to an appropriate payable account and allocated equity.²¹

The proposed definition of "common cooperative equity issuance date" is similar to the guidance previously provided by FCA; however, as proposed the

²¹ See Capital BL, item 7.

issuance date would be the quarter-end in which the board has declared a patronage refund and the applicable accounting treatment has taken place. As an example, a System institution board adopts a resolution to make a patronage distribution in cash and equity on December 15, 2020.²² On January 2, 2021, it makes a general ledger entry that moves the dollar amounts from URE to an appropriate payable account and allocated equity. The general ledger entry is made effective December 31, 2020 and is reflected in the yearend 2020 financial statements. On April 5, 2021, dollar amounts are assigned to each borrower. In this example, the "Common cooperative equity issuance date" would be December 31, 2020. If the System institution includes the equities in CET1 capital, they would need to hold the equities for at least 7 years from December 31, 2020 (i.e., December 31, 2027) to meet the minimum holding period requirement.

The holding period start date for purchased stock is slightly different from the holding period start

²² As discussed elsewhere in this preamble, the board declaration must include an amount it will pay in patronage or must include language whereas an amount could be calculated because it provides evidence of the board's intent to obligate the institution to pay a specific patronage amount to its member-borrowers.

date for allocated equities. Members purchase stock as a requirement of membership to borrow from the institution and the institution's bylaws allow for such issuance. Purchased stock would not result in a reallocation or reassignment of URE, but would result in new equity for the System institution. Accordingly, the holding period on purchased stock would be the quarter-end in which the System institution recognizes the stock on its financial statement.

We note that section 628.20(b)(1)(xiv)(B) allows for the statutory minimum borrower stock requirement to count as CET1 capital without any minimum holding period.²³ The statutory minimum borrower stock requirement under section 4.3A of the Act, is \$1,000 or 2 percent of the loan amount, whichever is less.

FCA believes this new approach to recognizing the start of the holding period, when combined with other proposed "Safe Harbor" related changes, results in a simplified "Safe Harbor" framework. More specifically, using the quarter-end date for the start of the holding period aligns with the proposed changes to the "Safe

²³ As discussed in greater detail under section 7 - Common Equity Tier 1 Capital Eligibility Requirements, statutory minimum borrower stock "funded" through the creation of a non-interest-bearing account receivable is not eligible for inclusion in CET1 or tier 2 capital.

Harbor Deemed Prior Approval," which we discuss above. As proposed, the "Safe Harbor" also would use a date that is the quarter-end after a board has declared a patronage payment. Furthermore, we believe using a quarter-end date reduces the burden for System institutions to track and monitor the amount of time equities have been outstanding. It also improves FCA's ability to monitor and enforce the "Safe Harbor" requirements.

Question 1: The FCA seeks comments on whether the new definition of "Common cooperative equity issuance date" creates a burden for System institutions due to the changes in established controls and processes that may be required. Please provide support for your position.

4. Farm Credit Leasing Services Corporation

The proposal removes Farm Credit Leasing from the list of institutions defined as System institutions in §§ 615.5201 and 628.2.²⁴ Under the proposal, Farm Credit Leasing as a stand-alone entity would no longer

²⁴ Farm Credit Leasing is a service corporation chartered under section 4.25 of the Act. A service corporation is a System institution established by System banks or associations and chartered by FCA, and it is subject to FCA regulation and examination. See title IV, subpart E of the Act.

be required to meet minimum capital and related regulatory requirements under part 615, subpart H, and part 628 of our regulations because of its current ownership status, as discussed below. If this ownership status were to change in the future, we would reassess the need for Farm Credit Leasing to independently meet capital requirements.²⁵

Farm Credit Leasing was previously owned by a group of System institutions but is now a wholly owned subsidiary of CoBank.²⁶ It is a business unit of the bank; profits and losses of the entity are accrued to the bank; and its assets and liabilities are consolidated with the bank's for financial and regulatory reporting purposes. CoBank's consolidation of Farm Credit Leasing ensures that minimum capital is appropriately held against Farm Credit Leasing's assets. The proposal would reduce the regulatory burden created by separately applying the minimum

²⁵ The definitions of "System institution" allows us to include any FCA-chartered institution that we determine should be included, even if it is not specifically referenced.

²⁶ In 1983, several System banks acquired an existing non-System corporation in the lease financing business that became Farm Credit Leasing. Farm Credit Leasing offers leasing services and related products to agribusiness, agricultural producers, rural infrastructure companies, and other related partners. As the System consolidated, the number of bank owners of Farm Credit Leasing declined. In 2004, CoBank acquired all Farm Credit Leasing stock outstanding, making it a wholly-owned subsidiary of the bank.

capital requirements and relevant capital regulations to Farm Credit Leasing on a stand-alone basis. The proposed change is not intended to reduce the amount of capital that must be held against Farm Credit Leasing and CoBank's combined assets.

Question 2: The FCA seeks comment on the appropriateness of removing the specific reference to Farm Credit Leasing from these provisions.

5. Lending and Leasing Limit Base Calculation

The proposal would amend § 614.4351 to change the composition and calculation of each System bank and association's lending and leasing limit base. The existing lending and leasing limit base is equal to the amount of a System institution's permanent capital as adjusted for the calculation of the permanent capital ratio in accordance with § 615.5207, and with two additional adjustments in § 614.4351(a) that apply only to the lending limit base. Section 614.4351(a)(1) provides that a System institution may count in its lending limit base any stock it purchases from another System institution in connection with the sale of a loan participation interest, and the other institution must exclude such stock from its lending limit base. Section 614.4351(a)(2) provides that any otherwise

eligible third-party capital instruments may be included in the lending limit base of a System institution, irrespective of the limits on third-party capital for the tier 1 / tier 2 capital ratios as outlined under § 628.23.

We propose two amendments to § 614.4351. First, instead of using permanent capital to calculate the lending limit base, institutions would use total capital as defined and adjusted in §§ 628.20 through 628.22 but including any otherwise eligible third-party capital that would be excluded under § 628.23. Second, we would eliminate the exceptional treatment of stock purchased in connection with a loan participation in § 614.4351(a)(1).

Our proposal to eliminate the existing exceptional treatment of stock purchased in connection with loan participations would align the lending and leasing limit base with the Capital Rule's treatment of investments in other System institutions. The Capital Rule requires institutions to deduct their investments in another System institution because it is the issuing institution, not the investing institution, that has discretion whether or not to retire the investment. FCA believes that equities should be counted in the

regulatory capital and the lending and leasing limit base of the institution that has control of the equities. This is a more accurate reflection of where the capital is available to absorb losses.

Our proposal would preserve the existing provision in § 614.4351(a)(2) which allows the inclusion of all otherwise qualifying third-party capital in the lending limit base, irrespective of limits on the inclusion of such instruments in regulatory capital under § 628.23. The requirements of § 628.23 recognize and emphasize the cooperative principles upon which System institutions operate by limiting the amount of non-cooperative equities that may be included in regulatory capital. Accordingly, we propose to continue to permit institutions to include all otherwise qualifying third-party capital in their lending limit base.

Our proposed changes to the calculation would result in modest changes in System institutions' lending limits.²⁷ Using total capital as the base instead of permanent capital would increase the lending and leasing limit for most System institutions due

²⁷ Under § 614.4360(b)(2), loans funded pursuant to a commitment that was within the lending and leasing limit at the time the commitment was made would not violate the lending and leasing limit if the limit subsequently declines.

primarily to the inclusion of at least a portion of the allowance for loan losses in total capital.²⁸ A small number of System institutions would see their lending limit decline due to various factors.²⁹ If both amendments are adopted, we estimate that about 16 institutions' lending limits would modestly decrease.³⁰ We note that most institutions have adopted policies that set significantly lower lending limits than the current regulation allows.

We adopted the Capital Rule to improve the quality and quantity of a System institution's capital, consistent with the objectives of the Basel III framework and the standardized approach of the Federal banking regulatory agencies (U.S. Rule). Accordingly, since 2017, FCA has focused on regulatory tier 1 and tier 2 capital when evaluating the safe and sound operation of a System institution rather than on

²⁸ Under § 628.20(d)(3), tier 2 capital (a component of total capital) includes the allowance for loan losses up to 1.25 percent of the institution's total risk-weighted assets not including any amount of the allowance.

²⁹ As of September 30, 2019, the vast majority of System institutions (banks and associations) would see their lending limit increase by 2.8 percent on average, with increases ranging from 0.5 percent to 8.3 percent. Two system institutions would see an average decrease of 2.2 percent.

³⁰ Including both the switch from permanent capital and the elimination of the loan participation-related treatment under § 614.4351(a)(1), 56 institutions would see their lending limit increase by 3.0 percent on average. The decrease at the remaining institutions would average 1.6 percent.

permanent capital.³¹ Similarly, we believe it is more appropriate to base the lending and leasing limit on the regulatory total capital of the institution and not on permanent capital.

Question 3: The FCA seeks comment on the proposed change to the lending base, and the continued appropriateness of the adjustment required in § 614.4351(a)(1), and whether its removal would have any significant adverse impacts on any System institution.

6. Qualified Financial Contract (QFC) Related Definitions

We are proposing to amend the definitions of "Collateral agreement," "Eligible margin loan," "Qualifying master netting agreement (QMNA)," and "Repo-style transaction" to incorporate amendments made to these definitions in the capital rules of the Federal banking regulatory agencies. Furthermore, the proposed amendment to the definition of "QMNA" will harmonize it with the amended definition of "Eligible master netting agreement (EMNA)" in FCA's Margin and

³¹ Section 301 of the Agricultural Credit Act of 1987 directed the FCA to adopt risk-based permanent capital regulations for System institutions.

Capital Requirements for Covered Swap Entities
regulation (Swap Margin Rule).³²

As part of the broader regulatory reform effort following the financial crisis, to increase the resolvability and resiliency of U.S. global systemically important banking institutions (GSIBs), the Federal banking regulatory agencies adopted final rules that establish restrictions on, and requirements for, certain financial contracts of GSIBs and their subsidiaries (QFC Rules).³³ Generally, these QFC Rules require covered qualified financial contracts³⁴ of covered entities (GSIBs and U.S. operations of foreign

³² See 83 FR 50805 (October 10, 2018).

³³ See 82 FR 56630 (November 29, 2017) (OCC); 82 FR 50228 (October 30, 2017) (FDIC); and 82 FR 42882 (September 12, 2017) (FRB).

³⁴ Qualified financial contracts generally include financial contracts for a derivative contract, repurchase agreement, reverse purchase agreement, and securities lending and borrowing agreement. When an entity goes into resolution under the U.S. Bankruptcy Code, attempts by the debtor entity's creditors to enforce their debt through any means other than participation in the bankruptcy proceeding, such as seizing collateral, are generally blocked by the imposition of an automatic stay (See 82 FR 42882, 42886 (September 12, 2017) citing 11 U.S.C. 362). However, the U.S. Bankruptcy Code generally exempts QFC counterparties of the debtor from the automatic stay through "safe harbor" provisions (See 11 U.S.C. 362(b)(6), (7), (17), (27), 362(o), 555, 556, 559, 560, 561. The U.S. Bankruptcy Code specifies the types of parties to which the safe harbor provisions apply). Under these provisions, any rights that a QFC counterparty has to terminate the contract, set off obligations, and liquidate collateral in response to a direct default are not subject to the stay and may be exercised against the debtor immediately upon default. We note that the Bankruptcy Code does not use the term "qualified financial contracts," but the set of transactions covered by its safe harbor provisions closely tracks the set of transactions that fall within the definition of "qualified financial contract" used in Title II of the Dodd-Frank Act.

GSIBs) to contain contractual provisions that opt into the "temporary stay-and-transfer treatment" of the Federal Deposit Insurance Act (FDI Act)³⁵ and Title II of the Dodd-Frank Act, thereby reducing the risk that the stay-and-transfer treatment would be challenged by a covered entity's counterparty or a court in a foreign jurisdiction. The stay-and-transfer treatment provides that the rights of a failed insured depository institution's or financial company's counterparties to terminate, liquidate, or net certain qualified financial contracts upon the appointment of the FDIC as receiver are temporarily stayed to allow for the transfer of the failed entities' qualified financial contracts to a solvent party.³⁶

As a result of the QFC Rules, the Federal banking regulatory agencies amended the definition of QMNA in their capital rules to prevent the QFC Rules from having a disruptive effect on the netting sets of their supervised institutions. The amended definition of QMNA is substantially similar to the previous definition and continues to recognize that default rights may be stayed if the financial company is in

³⁵ 12 U.S.C. 1811 et. seq.

³⁶ 12 U.S.C. 1821(e)(10)(B), 5390(c)(10)(B).

resolution under the Dodd-Frank Act or FDI Act, a substantially similar law applicable to GSEs, or a substantially similar foreign law, or where the agreement is subject by its terms to any of those laws.³⁷ However, the amended definition includes additional language permitting a master netting agreement to meet the definition of QMNA to the extent necessary to comply with the requirements of the QFC Rules even if the agreement limits the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of a counterparty. We are proposing a parallel change.

Additionally, the Federal banking regulatory agencies amended the definitions of "Collateral agreement," "Eligible margin loan," and "Repo-style transaction" to ensure that their supervised institutions can continue to recognize the risk-mitigating effects of financial collateral received in a secured lending transaction, repo-style transaction,

³⁷ Importantly, the Agriculture Improvement Act of 2018 amended section 5.61 of the Act to give the Farm Credit System Insurance Corporation receivership authorities parallel to those of the Federal banking regulatory agencies. Pub.L. 115-334, 132 Stat 4490 (2018).

or eligible margin loan.³⁸ The amendments to these definitions include conforming changes to provide that a counterparty's default rights may be limited as required by the QFC Rules.

In order to remain consistent, to the extent practical, with the capital rules of the Federal banking regulatory agencies, as well as aligning the definition of "Qualifying master netting agreement" with the recent amendments to the definition of "Eligible master netting agreement" in FCA's Swap Margin Rule, we propose to adopt parallel amendments to the definitions of "Collateral agreement," "Eligible margin loan," "Qualifying master netting agreement," and "Repo-style transaction." While the QFC rules primarily apply to GSIBs supervised by one of the Federal banking regulatory agencies, a System institution, as a counterparty to a GSIB, may need to ensure its qualified financial contracts include this new language recognizing the close-out restrictions imposed by the QFC Rules.

Without the proposed definitional changes, System institutions could potentially see higher capital

³⁸ See 82 FR 50228 (October 30, 2017) for further discussion.

charges imposed on certain counterparty exposures. The current definitions in our Capital Rule do not recognize the close-out restrictions on certain qualified financial contracts newly imposed by the QFC Rules. If a System institution incorporates these new close-out restrictions in contracts with an entity subject to the QFC Rules (i.e., GSIBs), the contract may not meet the existing definition of "Collateral agreement," "Eligible margin loan," "Qualifying master netting agreement," and "Repo-style transaction" in FCA's Capital Rule. As a result, a System institution may lose its ability to net offsetting exposures or recognize the risk-mitigating effects of financial collateral, thus resulting in a higher capital requirement for the System institution. Moreover, a System institution engaging in a derivative transaction that is subject to an EMNA, as defined in the Swap Margin Rule,³⁹ would lose the ability to net offsetting exposures for capital purposes. The proposed changes to the definitions of these terms would avoid these issues.

³⁹ See 83 FR 50805 (October 10, 2018).

The changes to these definitions do not result in System institutions waiving or eliminating their ability to exercise their rights against a defaulting party. Rather, consistent with other GSIB counterparties, the System institution would not be able to immediately exercise its rights against a defaulting party until the FDIC begins an orderly resolution of the counterparty. If a System institution is not transacting with an entity subject to the QFC Rules, these new restrictions would not be applicable.

Question 4: To what extent would the QFC Rules impact System institutions as counterparties to GSIBs or to U.S. operations of foreign GSIBs? For example, if FCA did not amend these definitions, what would be the result?

7. Common Equity Tier 1 Capital Eligibility Requirements

As discussed above, one of FCA's objectives in the Capital Rule is to ensure that the System's capital requirements are comparable to the Basel III framework and the U.S. Rule, taking into account the cooperative

structure of the System.⁴⁰ The Basel III framework specified the criteria that capital instruments must meet in order to be included in the different capital measures. Among these criteria is the requirement that an instrument be directly issued and paid-in.⁴¹ We are proposing to add the term “paid-in” to the eligibility criteria for CET1 capital in § 628.20(b)(1)(i), consistent with the criteria set forth in the Basel III framework and the U.S Rule.⁴² Basel III defines paid-in capital as capital that (1) has been received with finality by the institution, (2) is reliably valued, (3) is fully under the institution’s control, and (4) does not directly or indirectly expose the institution to the credit risk of the investor.⁴³

When we promulgated the Capital Rule, we did not require CET1 instruments to be paid-in because we had interpreted the term to exclude allocated equities. Allocated equities are the earnings of a System institution that the institution has converted to stock or to similar stock-like equities and allocated to member-borrowers.⁴⁴

⁴⁰ See 81 FR 49720 (July 28, 2016).

⁴¹ See BCBS, Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems, December 2010 (as revised June 2011).

⁴² See 12 CFR 217.20(b)(1)(i) (FRB); 12 CFR 324.20(b)(1)(i) (FDIC); 12 CFR 3.20(b)(1)(i) (OCC).

⁴³ See BCBS, Basel III Definition of capital – Frequently Asked Questions, September 2017 (update of FAQs published in December 2011).

⁴⁴ For a detailed discussion on allocated equities and its stock-like characteristics, see 81 FR 49727 (July 28, 2016).

Farm Credit banks routinely allocate equities to their affiliated associations and (in CoBank's case) to retail borrowers, and many of the associations routinely allocate equities to their retail borrowers. We have reexamined the attributes of allocated equities and determined that they fully meet the definition of paid-in capital: the allocated equities are received with finality by the allocating System institution when earned and issued; their value is reliably established as the dollar value of institution net assets allocated; they are fully under the institution's control because they can be revolved only at the discretion of the System institution, with the prior approval of the FCA;⁴⁵ and the loss-absorbing capacity of the allocated equities is not dependent on the creditworthiness of the member-borrower. We do not expect the proposed clarification to have any impact on System institution practices with respect to allocated equities.

FCA views the statutorily required borrower stock financed by the System institution as part of an overall loan commitment as meeting the Basel III criteria for paid-instruments.⁴⁶ However, borrower stock is not suitable for

⁴⁵ See §§ 628.20(b)(1)(iii) and (d)(x).

⁴⁶ For example, System institutions usually increase a borrower's loan commitment by \$1,000 in order to cover the stock or participation certificate purchase. While the loan commitment will increase by

inclusion in CET1 if it is funded using non-interest-bearing account receivables.⁴⁷

We also propose a conforming change in § 628.20(d)(1)(i) to clarify that all instruments included in tier 2 capital must be issued and paid-in.

In addition, we are proposing minor changes to § 628.20(b)(1)(i) and (b)(1)(ii) to align the language more closely to the language in the U.S. Rule and at the same time to emphasize a difference from the U.S. Rule. Specifically, the U.S. Rule requires CET1 instruments to entitle the holder to a claim on residual assets (after all senior claims have been satisfied) that is proportional to the holder's share of issued capital. Our rule does not require the equity holder's claim to be proportional. This

\$1,000, those funds are not disbursed to the borrower and are retained by the institution to cover the purchase. We note that under FCA Regulation § 628.20(b)(1)(x), statutory borrower stock required under section 4.3A of the Act is not considered to be "directly or indirectly" funded as long as: (A) the purpose of the loan is not the purchase of capital instruments of the System institution providing the loan, and (B) the purchase of acquisition of one or more member equities of the institution is necessary in order for the beneficiary of the loan to become a member of the institution. This approach follows the approach of the European Banking Authority regarding the standards for CET1 instruments for cooperatives. See 79 FR 52824 (September 4, 2014) for additional discussion.

⁴⁷ "Stock" funded in this manner has not been received with finality by the System institution and exposes the System institution to the credit risk of the borrower. On December 27, 2019, the FCA Board used its reservation of authority in § 628.1(d)(2)(i) to determine that borrower stock funded through the creation of a non-interest-bearing account receivable in the borrower's name has characteristics and terms that diminish its ability to absorb losses and is not suitable for inclusion in CET1 or tier 2 capital.

is because, unlike commercial banks and mutual associations that do not allocate equities, System institutions may have liquidation bylaws that prioritize residual payments among different classes of common cooperative equityholders if there are assets remaining after all classes have received par or face value of their equities. We believe these changes to § 628.20(b)(1) are not substantive.

B. Clarifying and Other Revisions to the Capital Rule

The proposed amendments to the Capital Rule discussed in this section incorporate issues discussed in the Capital BL, with appropriate adjustments. In addition, we propose to make other changes to the Capital Rule that clarify Agency position.

1. Capitalization Bylaw Adjustment

Section 615.5220(a)(6) requires System institutions to include in their capitalization bylaws a provision stating that equities other than those protected under section 4.9A of the Act are retireable at the sole discretion of the board, provided minimum capital adequacy standards established in subpart H of this part (615) and part 628 of this chapter are met. We propose to amend this section by replacing the reference to parts 615 and 628 with a general reference to FCA regulations. A general reference to FCA's

capital adequacy standards would satisfy the requirement to reference parts 615 and 628 and would incorporate all capital requirements of the FCA, as well as any future capital requirements that could potentially be adopted under a new or different part.

If a System institution has already amended its capitalization bylaws to include a reference to both part 615 and 628, it would not need to amend its capitalization bylaws to replace those references with a general reference to capital adequacy standards established by FCA. As discussed above, a reference to both part 615 and part 628 would satisfy the proposed requirement for an institution's capitalization bylaws to include a general reference to capital adequacy standards established by FCA. However, if the bylaws reference only part 615 subpart H, or reference only part 628, this would not satisfy the requirement we are proposing. In these instances, a System institution would have to amend its capitalization bylaws to include a general reference to capital adequacy standards established by FCA.

System institution changes to its bylaws to conform to this regulatory requirement should not change any substantive rights of the System institution

or its member-borrowers. If the change is non-substantive and does not alter, reduce, or increase the rights of any member-borrowers, a System institution's board may choose to make a conforming change to their capitalization bylaws to include a general reference to regulatory capital adequacy standards without a vote by its member-borrowers, assuming such bylaws allow for technical amendments without a shareholder vote.

2. Annual Report to Shareholder Corrections

In existing § 620.5, which lists the required contents of a System institution's annual report, we propose technical revisions to ensure institutions report financial data as we intended. System associations must report their tier 1 leverage ratio in each annual report for each of the last 5 fiscal years. This requirement was inadvertently placed in paragraph (f)(4)(iv) of § 620.5. We propose to move the requirement from § 620.5(f)(4)(iv) and place it in proposed § 620.5(f)(3)(v), as originally intended.

In addition, we propose to amend the requirement in § 620.5(f)(4) that System institutions report core surplus, total surplus, and the net collateral ratio (banks only) in a comparative columnar form for each fiscal year ending in 2012 through 2016. System

institutions must currently report these ratios in each annual report through 2021, in addition to reporting the capital ratios required under § 620(f)(2) and (3), resulting in System institutions reporting capital ratios beyond the 5-year requirement established in § 620.5(f). Accordingly, we propose to revise § 620.5(f)(4) to require these disclosures in each annual report through 2021 but only as long as these ratios are part of the previous 5 fiscal years for which disclosures are required. For example, the fiscal year ending 2020 annual report to shareholders would report the permanent capital ratio, CET1 capital ratio, tier 1 capital ratio, total capital ratio, and tier 1 leverage ratio for the fiscal years ending in 2017 - 2020, and the core surplus ratio, total surplus, ratio, and net collateral ratio for the fiscal year ending in 2016 only.

3. Appropriate Risk-Weighting of Cash

Existing § 628.32(1)(1) states, among other things, that a System institution must assign a 0-percent risk-weight to cash held in accounts at a depository institution. This provision may create confusion about the proper risk-weight for deposits that exceed the limit of FDIC deposit insurance

coverage (currently set at \$250,000). Accordingly, we propose to delete this provision. It is unnecessary to address in § 628.32(1)(1) the risk-weight assigned to cash held in depository institution accounts, because other provisions more accurately address this risk-weight. Specifically, § 628.32(a)(1)(i)(B) requires a System institution to assign a 0-percent risk-weight to the portion of an exposure that is directly and unconditionally guaranteed by the U.S. Government, its central bank, or a U.S. Government agency, including a deposit or other exposure or the portion of a deposit or other exposure that is insured or otherwise unconditionally guaranteed by the FDIC or National Credit Union Administration. Section 628.32(d)(1) requires a System institution to assign a 20-percent risk-weight to exposures to U.S. depository institutions and credit unions that are not assigned a 0-percent risk-weight under § 628.20(a)(1)(i)(B). We confirm that the 20-percent risk-weight applies, for example, to a System institution's deposit with an FDIC-insured bank of funds in excess of the deposit insurance coverage of \$250,000.

Existing § 628.32(1)(1) also states that System institutions must assign a 0-percent risk-weight to

cash held in accounts at a Federal Reserve Bank. We propose to remove this provision because it is redundant. Section 628.32(a)(1)(i)(A) assigns a 0-percent risk-weight to an exposure to the central bank of the United States government, which includes Federal Reserve Banks.

Finally, we propose to revise § 628.32(1)(1) to add a provision generally assigning a 0-percent risk-weight to gold bullion held in the System institution's own vaults. The existing provision already generally assigns a 0-percent risk-weight to gold bullion held in the vaults of a depository institution.

4. Securitization Formulas

The proposed rule would correct 3 formulas used in the simplified supervisory formula approach (SSFA) equation under § 628.43(d) and one formula used in the simple risk-weight approach (SRWA) under § 628.52. These formulas were printed incorrectly in the *Federal Register* version of the Tier 1/Tier 2 Capital Framework final rule. We previously provided the correct formulas in our Capital BL. These are technical corrections to ensure these approaches are calculated correctly.

5. Unallocated Retained Earnings and Equivalents Deductions and Adjustments

The proposed rule would clarify the calculation of the requirement described in § 628.10 that at least 1.5 percent of the 4 percent tier 1 leverage ratio minimum must consist of URE and URE equivalents (UREE). The Capital Rule did not specify how to calculate this requirement. In our Capital BL, we provided guidance to System institutions on the deductions to make when calculating this minimum URE and UREE requirement.⁴⁸ We stated: "When calculating the URE and URE equivalents requirement for the leverage ratio, a System institution must deduct from the numerator an amount equal to all the deductions required under § 628.22(a). All deductions made to the denominator when calculating the tier 1 leverage ratio must be made to the denominator when calculating the URE and URE equivalents requirement."⁴⁹

⁴⁸ See Capital BL, item 4.

⁴⁹ Section 628.10(c)(4) requires the amounts deducted under §§ 628.22(a) and (c) and 628.23 to be deducted from tier 1 capital when calculating the tier 1 leverage ratio. However, the deductions under §§ 628.22(c) and 628.23 were not applied to the numerator when calculating the URE and UREE requirement as they do not increase the URE of a System institution.

We propose to add the Capital BL guidance to § 628.10. We also propose to require System institutions to deduct purchased equity investments that are required to be deducted under the corresponding deduction approach in § 628.22(c). The URE and UREE measure, because it is a component of the tier 1 leverage ratio, should have similar deductions.⁵⁰ While the URE and UREE measure represents only a part of the numerator of the tier 1 leverage ratio, our previous guidance to deduct such amounts only from § 628.22(a) resulted in the majority of System institution's URE and UREE measures being higher than the tier 1 leverage ratio, which was not our intention. We believe our proposed deduction of purchased stock under § 628.22(c) will have a minimal impact on System institutions and will not result in any System institution's URE and UREE measure falling below the regulatory minimum.⁵¹ In addition, when calculating the URE and UREE measure, System institutions must continue to use the same

⁵⁰ We do not find it necessary to require the deductions under § 628.23 as third-party stock is not a component of URE, UREE, or CET1 capital.

⁵¹ As of September 30, 2019, the inclusion of deductions under § 628.22(c) in the computation of the URE and UREE measure would have decreased the ratio at System institutions by 1 percent on average. With computations including the deductions under § 628.22(c), all institutions remain well above the regulatory minimum.

denominator as the tier 1 leverage ratio. The denominator is equal to the institution's average total consolidated assets as reported on the institution's Call Report minus amounts deducted from tier 1 capital under §§ 628.22(a), and (c) and 628.23.⁵²

Question 5: The FCA seeks comment on the appropriate deductions and adjustments that should be made to URE and URE equivalents in determining compliance with § 628.10(b)(4).

6. Service Corporation Deductions and Adjustments

The proposed rule would expand the requirement under existing § 628.22(a)(6) for a System institution to deduct any allocated equity investment in another System institution, which is defined in part 628 to mean each System bank or association,⁵³ by requiring a System institution also to deduct any allocated equity investment in a System service corporation.

Although we do not know of any allocation of equities by a service corporation to another

⁵² As of the date of this proposal, this would be total average assets for leverage ratio on schedule RC-R.5, line 1.d.

⁵³ "System institution" is defined in existing § 628.2 as "a System bank, an association of the Farm Credit System, . . . and any other institution chartered by the FCA that the FCA determines should be considered a System institution for the purposes of this part." The FCA has not made any determinations to include other institutions in this definition.

institution in the System, a service corporation's bylaws may permit it to allocate equities to another System institution. The allocated equity is retained, controlled, and at risk at the service corporation. Therefore, consistent with FCA's stated position that equities should be counted in the regulatory capital of the System institution that has control of the equities rather than at the System institution that does not control them, these allocated equities should be counted at the service corporation as applicable, and deducted from the regulatory capital of the recipient System institution.

Question 6: The FCA seeks comment on whether any System institution has received an allocated equity investment from a service corporation.

7. Adjustments for Accruing Patronage and Dividends

We propose to amend the regulatory capital adjustment and deduction requirements under § 628.22 by including in proposed § 628.22(b) the existing requirement to reverse any accruals of patronage or dividend payables or receivables that occur prior to a board declaration resolution.⁵⁴ Under GAAP,

⁵⁴ See existing Call Report instructions for Schedule RC-R.4, Line item 3 at <https://www.fca.gov/bank-oversight/fcs-call-reports>.

institutions that make patronage and dividend payments that can be reasonably estimated on a regular and routine basis may accrue those payments as payables. Similarly, institutions that receive patronage and dividend payments that can be reasonably estimated on regular and routine basis may accrue those payments as receivables. Many System institutions accrue these payables or receivables on their balance sheet prior to the board adopting a declaration resolution. For regulatory capital purposes only, these institutions must adjust their unallocated retained earnings as follows:

- If a System institution accrues a patronage or dividend receivable prior to the date of the board declaration resolution by the paying institution, then it must subtract this accrual from its URE.
- If a System institution accrues a patronage or dividend payable to either another institution or a borrower prior to the date of its board declaration resolution, then it must add it back to URE.

If the System institution chooses not to accrue a payable or receivable until it is declared by the board, then no adjustments to regulatory capital are

necessary. Any adjustment to accruals made pursuant to this provision is applicable only to regulatory capital measures as reported to FCA.

8. Bank Disclosures

The proposed rule would amend § 628.63(b)(4) by requiring banks to disclose a reconciliation of their regulatory capital elements as they relate to their balance sheets in any audited consolidated financial statements. We propose to add the word "applicable" before "audited" to clarify that this reconciliation requirement applies only to current period financial statements that are audited. There is no requirement to reconcile with audited financial statements from previous quarters. Specifically, if a System bank audits only its year-end financial statements, and not its quarterly financial statements (as is the general practice of System banks), this requirement would apply only to the bank's annual report to shareholders. The reconciliation applies to quarterly shareholder reports only if the reports are audited.

We also propose to require System banks to disclose the reconciliation of regulatory capital elements using both point-in-time and three-month average daily balance regulatory capital values.

Section 628.10(a) requires a System institution to compute its regulatory capital ratios using average daily balances for the most recent 3 months. Existing § 628.63(b)(4) does not specify whether to complete the reconciliation using point-in-time or average daily balance regulatory capital values.

FCA has long required institutions to compute their capital ratios using three-month average daily balances; so we believe it is appropriate that the reconciliation to any applicable audited consolidated financial statements also use the three-month average daily balances. One of the primary purposes of this requirement is to address the disconnect between the numbers used for the calculation of regulatory capital and the numbers used in published financial statements. Because FCA measures and monitors regulatory capital using average daily balances, we believe the reconciliation using average daily balances is the most accurate and beneficial way to disclose differences between regulatory capital and audited consolidated financial statements.

We believe it is also appropriate to include the reconciliation using point-in-time values. The audited consolidated financial statement uses point-in-time

values; therefore, also completing the reconciliation using point-in-time values allows for a comparison between GAAP and regulatory capital using point-in-time numbers. Disclosing the reconciliation using both average daily and point-in-time values provides investors and stockholders with the most accurate, complete, and transparent means to understanding differences between regulatory capital and GAAP capital.

In addition, we propose to further clarify System disclosures as follows: Existing § 620.3 requires disclosures by institutions and by employees, officers, directors, and institution director nominees to be "complete." Section 628.62(a) requires disclosures from System banks as outlined in § 628.63. Section 628.62(c) permits a System bank, in certain situations, not to disclose certain information that it would otherwise be required to disclose under § 628.63 and to instead disclose more limited information. Specifically, § 628.62(c) permits a System bank not to disclose specific proprietary or confidential commercial or financial information that it would otherwise be required to disclose if it concludes that such disclosures would compromise its position, as long

as it discloses more general information about the subject matter, together with the fact that, and the reasons why, the specific items of information are not being disclosed.

To clarify that § 620.3 does not require the disclosure of information that banks may properly not disclose under § 628.62(c), we propose to revise § 620.3 to state that unless otherwise determined by FCA, the use of the authorized limited disclosure does not create an incomplete disclosure. We also propose to revise § 620.3 to permit the modification of the required statement that the information provided is true, accurate, and complete to explain that the completeness of the disclosure was determined in consideration of § 628.62(c).

We are also proposing a technical edit to remove and reserve § 628.63(b)(3) because it is no longer applicable.

Question 7: The FCA seeks comment on the appropriateness and usefulness to internal and/or external stakeholders of completing the reconciliation using both point-in-time and average daily balance values?

9. Retirement of Statutory Borrower Stock

Existing § 628.20(b)(1)(xiv)(B) allows System institutions to redeem the minimum statutory borrower stock described in § 628.20(b)(1)(x) without prior FCA approval and without satisfying the minimum holding period for common cooperative equities included in CET1 capital. We propose to add a provision expressly stating that an institution may redeem such statutory borrower stock only provided that, after such redemption, the institution continues to comply with all minimum regulatory capital requirements.

Although the existing rule is silent on whether the institution must maintain compliance with the regulatory capital standards, institutions have been required to do so by the Act and FCA regulations since 1988. Section 4.3A(c)(1)(I) of the Act and § 615.5220(a)(6) condition the retirement of stock on the institution meeting the minimum capital adequacy standards established by FCA. The proposed amendment to § 628.(b)(1)(xiv)(B) would eliminate any possible misinterpretation that an institution could retire the statutory borrower stock if the institution were not meeting its regulatory capital requirements both before and after the retirement.

Although we are not proposing additional changes to the treatment of statutory borrower stock, we provide the following additional clarifications:

- For any statutory borrower stock that exceeds \$1,000 or 2 percent of the loan amount, whichever is less, the minimum holding periods apply (7 years for CET1 and 5 years for Tier 2) if an institution plans to include the additional stock in tier 1 or tier 2 capital.
- The minimum statutory borrower stock includible in CET1 is the outstanding balance of the statutory minimum borrower stock. If a loan is for \$50,000 or more, the amount includible in CET1 capital without a minimum holding period is no more than \$1,000 until such stock is retired. If a loan is for less than \$50,000 at origination, the amount includible in CET1 capital is 2 percent of the originated loan amount until such stock is retired. If a revolving line of credit is originated for \$50,000 or more and the amount of borrower stock is retired as the loan pays down, the amount of stock remaining on the calculation date, up to \$1,000, is the amount includible in CET1 without a minimum holding period. If a

revolving line of credit is originated for less than \$50,000 and the amount of borrower stock is retired as the loan pays down, the amount of stock remaining on the calculation date, up to 2 percent of the originated loan amount, is the amount includible in CET1 without a minimum holding period.

C. General Discussion

FCA is using this notice of proposed rulemaking to provide further clarification and guidance to the System on continuously redeemable preferred stock and to respond to a letter received from the Farm Credit Council. We also seek comment on potential changes that may be made to FCA's existing permanent capital regulations.

1. Continuously Redeemable Preferred Stock (H Stock)

Some System associations have issued continuously redeemable perpetual preferred stock (typically called Harvest Stock or H Stock) to their member-borrowers to invest and participate in their cooperative beyond the minimum borrower stock purchase. H Stock is an at-risk investment, issued without a stated maturity and retireable only at the discretion of the institution's board. A feature of the stock is the institution's

intent to redeem it upon the request of the holder as long as the institution is in compliance with its regulatory capital requirements. Because of this feature, FCA considers the stock to be continuously redeemable. Some of the institutions also lower the operational hurdles to redemption by delegating the board's authority to retire all member-borrower stock to management provided certain board-approved minimum regulatory capital ratios are maintained. FCA has determined that holders reasonably expect the institution to redeem the stock shortly after they make a request and, therefore, the stock does not meet the requirements of § 628.20(b)(1)(iv), § 628.20(c)(1)(xiv)(A) or § 628.20(d)(1)(xi)(A) for inclusion in tier 1 or tier 2 capital. Even after the stock has been outstanding for 5 years or more, the continued policy of the institutions to redeem this stock upon request and the continued expectations of holders disqualify the stock for inclusion in tier 1 or tier 2 capital.

2. Farm Credit Council Letter

In addition, FCA has received a letter from the Farm Credit Council on behalf of System banks and

associations (System Letter)⁵⁵ recommending changes to the risk-weighting of investments by System institutions in service corporations and unincorporated business entities (UBEs).

The System Letter requests that a System institution's investment in a service corporation be risk-weighted at 100 percent instead of being deducted from CET1 capital. The stated basis for such treatment is that investments in service corporations are approved by their respective owners that closely control their activities, and the service corporations do not possess lending authorities (i.e., they do not assume exposure to credit risks).

The System Letter also recommended directing System institutions to either risk-weight or deduct their investments in UBEs, depending on the specific nature of the UBE.⁵⁶ The letter suggests that institutions with an equity investment in AgDirect, LLP should deduct the investment from regulatory capital.

⁵⁵ Letter dated November 22, 2016, from Charles Dana, General Counsel, Farm Credit Council to Gary K. Van Meter, Director, Office of Regulatory Policy. The Farm Credit Council is a trade association representing the interests of System banks and associations. This letter was received after the final Capital Rule had been adopted by the FCA Board and communicates a request to change certain provisions of the final Capital Rule, as discussed in this section.

⁵⁶ Under the existing rules, equity investments in UBEs are generally included in risk-weighted assets in accordance with § 628.52.

We have considered the request and have decided not to propose that institutions risk-weight equity investments in service corporations instead of deducting such investments. FCA continues to believe that such capital investments are committed to support risks at the service corporation level and that such capital investments must be available to meet any capital needs of the service corporation.⁵⁷

With respect to the treatment of UBEs, FCA may consider the appropriate regulatory capital treatment of the UBE and apply such treatment on a case-by-case determination, as appropriate.

FCA clarifies that the Farm Credit System Association Captive Insurance Company (Captive Insurance Company) is not a System institution as defined in § 628.2. Accordingly, any System institution with an equity investment in the Captive Insurance Company must risk-weight that equity investment.

3. Permanent Capital

In 1988, Congress added a definition of "permanent capital" to the Act and required the FCA to adopt risk-

⁵⁷ See 63 FR 39222 (July 22, 1998).

based permanent capital standards for System institutions. The FCA adopted permanent capital regulations in 1988.⁵⁸

The Act defines permanent capital to include current earnings, unallocated and allocated earnings,⁵⁹ stock (other than stock retireable on repayment of the holder's loan or at the discretion of the holder, and certain stock issued before October 1988), surplus less allowance for loan losses, and other debt or equity instruments that the FCA determines appropriate to be considered permanent capital. Allocated equities shared by a bank and each affiliated association—that is, equities that a bank has allocated to an affiliated association—appear on the books of both institutions but can be counted in only one institution's permanent capital pursuant to a capital allotment agreement between the two institutions.

By adopting and implementing the Tier 1/Tier 2 Capital Framework, FCA has shifted its focus from permanent capital to total capital (tier 1 and tier 2). Because the Act defines permanent capital, FCA must

⁵⁸ See 53 FR 39229 (October 6, 1988).

⁵⁹ In this preamble, "unallocated and allocated earnings" would be equivalent to "unallocated retained earnings and allocated equities." Additionally, "surplus" would be "unallocated retained earnings."

require reporting and monitoring of permanent capital. Moreover, FCA has limited authority to change the components of permanent capital. However, the FCA has full authority to implement appropriate deductions to permanent capital in the numerator and set the risk-weights used in risk-adjusted assets in the denominator of the permanent capital ratio. FCA seeks to reduce the burden associated with permanent capital, and we seek comment on the best way to do so consistent with statutory mandates. We note that H Stock, in its current form, is included in permanent capital and FCA does not seek to exclude H Stock from permanent capital.

Question 8: What, if any, changes to the permanent capital regulations (§§ 615.5201, 615.5206, 615.5207, and 615.5208) should be made to increase their clarity and understanding?

Question 9: Is calculating permanent capital burdensome for System institutions? If so, are there any changes FCA could make to this calculation that would reduce this burden, considering that the definition of permanent capital in the Act precludes us from changing the components of permanent capital?

Question 10: Should FCA more closely align the permanent capital calculation with the total capital (tier 1 and tier 2) calculations? If so, how could FCA accomplish this, considering that for permanent capital, the Act specifies deductions related to bank and association allotment agreements?

III. Abbreviations

BCBS	Basel Committee on Banking Supervision
CFR	Code of Federal Regulations
CFTC	Commodity Futures Trading Commission
EMNA	Eligible Master Netting Agreement
FCA	Farm Credit Administration
FDIC	Federal Deposit Insurance Corporation
FDI Act	Federal Deposit Insurance Corporation Improvement Act of 1991
FFIEC	Federal Financial Institutions Examination Council
FR	<u>Federal Register</u>
GAAP	Generally Accepted Accounting Principles (U.S.)
GSE	Government-Sponsored Enterprise
GSIB	Global Systemically Important Bank
OCC	Office of the Comptroller of the Currency
QFC	Qualified Financial Contract
QMNA	Qualified Master Netting Agreement
SEC	Securities and Exchange Commission
SFA	Supervisory Formula Approach
SRWA	Simple Risk-Weight Approach
SSFA	Simplified Supervisory Formula Approach
UBE	Unincorporated Business Entity
URE	Unallocated Retained Earnings
UREE	Unallocated Retained Earnings Equivalents
U.S.C.	United States Code

IV. Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), FCA hereby

certifies that this proposed rule will not have a significant economic impact on a substantial number of small entities. Each of the banks in the Farm Credit System, considered together with its affiliated associations, has assets and annual income in excess of the amounts that would qualify them as small entities. Therefore, Farm Credit System institutions are not "small entities" as defined in the Regulatory Flexibility Act.

Lists of Subjects

12 CFR Part 614

Agriculture, Banks, Banking, Foreign trade, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 615

Accounting, Agriculture, Banks, Banking, Government securities, Investments, Rural areas.

12 CFR Part 620

Accounting, Agriculture, Banks, Banking, Reporting and recordkeeping requirements, Rural areas.

12 CFR Part 628

Accounting, Agriculture, Banks, Banking, Capital, Government securities, Investments, Rural areas.

For the reasons stated in the preamble, the Farm Credit Administration proposes to amend parts 614, 615,

620 and 628 of chapter VI, title 12 of the Code of Federal Regulations as follows:

PART 614--LOAN POLICIES AND OPERATIONS

1. The authority citation for part 614 is revised to read as follows:

Authority: secs. 1.3, 1.5, 1.6, 1.7, 1.9, 1.10, 1.11, 2.0, 2.2, 2.3, 2.4, 2.10, 2.12, 2.13, 2.15, 3.0, 3.1, 3.3, 3.7, 3.8, 3.10, 3.20, 3.28, 4.12, 4.12A, 4.13B, 4.14, 4.14A, 4.14D, 4.14E, 4.18, 4.18A, 4.19, 4.25, 4.26, 4.27, 4.28, 4.36, 4.37, 5.9, 5.10, 5.17, 7.0, 7.2, 7.6, 7.8, 7.12, 7.13, 8.0, 8.5 of the Farm Credit Act (12 U.S.C. 2011, 2013, 2014, 2015, 2017, 2018, 2019, 2071, 2073, 2074, 2075, 2091, 2093, 2094, 2097, 2121, 2122, 2124, 2128, 2129, 2131, 2141, 2149, 2183, 2184, 2201, 2202, 2202a, 2202d, 2202e, 2206, 2206a, 2207, 2211, 2212, 2213, 2214, 2219a, 2219b, 2243, 2244, 2252, 2279a, 2279a-2, 2279b, 2279c-1, 2279f, 2279f-1, 2279aa, 2279aa-5); sec. 413 of Pub. L. 100-233, 101 Stat. 1568, 1639, as amended by section 405 of Pub. L. 100-399, 102 Stat. 1000 (12 U.S.C. 2121 note); 42 U.S.C. 4012a, 4104a, 4104b, 4106, and 4128.

2. Amend § 614.4351 by:

a. Revising paragraph (a);

b. Removing and reserving paragraph (a)(1); and

c. Revising paragraph (a) (2) .

The revisions read as follows:

§ 614.4351 Computation of lending and leasing limit base.

(a) *Lending and leasing limit base.* An institution's lending and leasing limit base is composed of the total capital (Tier 1 and Tier 2) of the institution, as defined in § 628.2 of this chapter, with adjustments applicable to the institution provided for in § 628.22 of this chapter, and with the following further adjustments:

(1) [Reserved]

(2) Eligible third-party capital that is required to be excluded from total capital under § 628.23 of this chapter may be included in the lending limit base.

* * * * *

PART 615—FUNDING AND FISCAL AFFAIRS, LOAN POLICIES AND OPERATIONS, AND FUNDING OPERATIONS

3. The authority citation for part 615 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 8.0, 8.3, 8.4, 8.6, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015,

2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211, 2243, 2252, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L. 100-233, 101 Stat. 1568, 1608 (12 U.S.C. 2154 note); sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note).

4. Amend § 615.5200 by replacing the existing language with the following language:

§ 615.5200 Capital planning.

(a) The Board of Directors of each System institution shall determine the amount of regulatory capital needed to assure the System institution's continued financial viability and to provide for growth necessary to meet the needs of its borrowers. The minimum capital standards specified in this part and part 628 of this chapter are not meant to be adopted as the optimal capital level in the System institution's capital adequacy plan. Rather, the standards are intended to serve as minimum levels of capital that each System institution must maintain to protect against the credit and other general risks inherent in its operations.

(b) Each Board of Directors shall establish, adopt, and maintain a formal written capital adequacy plan as a part of the financial plan required by § 618.8440 of this chapter. The plan shall include the capital targets that are necessary to achieve the System institution's capital adequacy goals as well as the minimum permanent capital, common equity tier 1 (CET1) capital, tier 1 capital, total capital, and tier 1 leverage ratios (including the unallocated retained earnings (URE) and URE equivalents minimum) standards. The plan shall expressly acknowledge the continuing and binding effect of all board resolutions adopted in accordance with §§ 628.20(b)(1)(xiv), (c)(1)(xiv), (d)(1)(xi), and 628.21. The plan shall address any projected dividend payments, patronage payments, equity retirements, or other action that may decrease the System institution's capital or the components thereof for which minimum amounts are required by this part and part 628 of this chapter. The plan shall set forth the circumstances and minimum timeframes in which equities may be redeemed or revolved consistent with the System institution's applicable bylaws or board of directors' resolutions.

(c) In addition to factors that must be considered in meeting the minimum standards, the board of directors shall also consider at least the following factors in developing the capital adequacy plan:

(1) Capability of management and the board of directors (the assessment of which may be a part of the assessments required in paragraphs (b)(2)(ii) and (b)(7)(i) of § 618.8440 of this chapter);

(2) Quality of operating policies, procedures, and internal controls;

(3) Quality and quantity of earnings;

(4) Asset quality and the adequacy of the allowance for losses to absorb potential loss within the loan and lease portfolios;

(5) Sufficiency of liquid funds;

(6) Needs of a System institution's customer base; and

(7) Any other risk-oriented activities, such as funding and interest rate risks, potential obligations under joint and several liability, contingent and off-balance-sheet liabilities or other conditions warranting additional capital.

5. Amend § 615.5201 by revising the definition of "System institution" to read as follows:

§ 615.5201 Definitions.

* * * * *

System institution means a System bank, an association of the Farm Credit System, and their successors, and any other institution chartered by the FCA that the FCA determines should be considered a System institution for the purposes of this subpart.

6. Amend § 615.5220 by revising paragraph (a) (6) to read as follows:

§ 615.5220 Capitalization bylaws.

(a) * * *

(6) The manner in which equities will be retired, including a provision stating that equities other than those protected under section 4.9A of the Act are retireable at the sole discretion of the board, provided minimum capital adequacy standards established by the Farm Credit Administration, and the capital requirements established by the board of directors of the System institution, are met;

* * * * *

PART 620—DISCLOSURE TO SHAREHOLDERS

7. The authority citation for part 620 continues to read as follows:

Authority: Secs. 4.3, 4.3A, 4.19, 5.9, 5.17, 5.19 of the Farm Credit Act (12 U.S.C. 2154, 2154a, 2207, 2243, 2252, 2254); sec. 424 of Pub. L. 100-233, 101 Stat. 1568, 1656; sec. 514 of Pub. L. 102-552, 106 Stat. 4102.

8. Amend § 620.3 by adding in paragraphs (a) and (c) (3) a new last sentence to read as follows.

§ 620.3 Accuracy of reports and assessment of internal control over financial reporting.

(a) * * * Unless otherwise determined by FCA, the appropriate use of the limited disclosure authorized by § 628.62(c) does not create an incomplete disclosure.

* * * * *

(c) * * *

(3) * * * If the report contains the limited disclosure authorized by § 628.62(c), the statement may be modified to explain that the completeness of the report was determined in consideration of § 628.62(c).

* * * * *

9. Amend § 620.5 by:

- a. Adding paragraph (f) (3) (v);
- b. Revising (f) (4).

The addition and revision read as follows:

§ 620.5 Contents of the annual report to shareholders.

* * * * *

(f) * * *

(3) * * *

(v) Tier 1 leverage ratio.

(4) The following ratios shall be disclosed in comparative columnar form in each annual report through fiscal year end 2021, only as long as these ratios are part of the previous 5 fiscal years of financial data required under § 620.5(2) and (3):

(i) Core surplus ratio.

(ii) Total surplus ratio.

(iii) For banks only, net collateral ratio.

* * * * *

PART 628--CAPITAL ADEQUACY OF SYSTEM INSTITUTIONS

10. The authority citation for part 628 is revised to read as follows:

Authority: Secs. 1.5, 1.7, 1.10, 1.11, 1.12, 2.2, 2.3, 2.4, 2.5, 2.12, 3.1, 3.7, 3.11, 3.25, 4.3, 4.3A, 4.9, 4.14B, 4.25, 5.9, 5.17, 8.0, 8.3, 8.4, 8.6, 8.8, 8.10, 8.12 of the Farm Credit Act (12 U.S.C. 2013, 2015, 2018, 2019, 2020, 2073, 2074, 2075, 2076, 2093, 2122, 2128, 2132, 2146, 2154, 2154a, 2160, 2202b, 2211,

2243, 2252, 2279aa, 2279aa-3, 2279aa-4, 2279aa-6, 2279aa-8, 2279aa-10, 2279aa-12); sec. 301(a), Pub. L. 100-233, 101 Stat. 1568, 1608 ((12 U.S.C. 2154 note); sec. 939A, Pub. L. 111-203, 124 Stat. 1326, 1887 (15 U.S.C. 78o-7 note).

11. Amend § 628.2 by:

- a. Revising the definition of "Collateral agreement";
- b. Adding in alphabetical order a definition for "Common cooperative equity issuance date";
- c. Revising the definition of "Eligible margin loan";
- d. Revising the definition of "Qualifying master netting agreement";
- e. Revising the definition of "Repo-style transaction";
- f. Revising the definition of "System institution".

The revisions and addition read as follows:

§ 628.2 Definitions

* * * * *

Collateral agreement means a legal contract that specifies the time when, and circumstances under which, a counterparty is required to pledge collateral to a System institution for a single financial contract or

for all financial contracts in a netting set and confers upon the System institution a perfected, first-priority security interest (notwithstanding the prior security interest of any custodial agent), or the legal equivalent thereof, in the collateral posted by the counterparty under the agreement. This security interest must provide the System institution with a right to close-out the financial positions and liquidate the collateral upon an event of default of, or failure to perform by, the counterparty under the collateral agreement. A contract would not satisfy this requirement if the System institution's exercise of rights under the agreement may be stayed or avoided:

(1) Under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (1)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (1)(i) of this definition; or

(2) Other than to the extent necessary for the counterparty to comply with the requirements of part 47, Subpart I of part 252 or part 382 of Title 12, as applicable.

* * * * *

Common cooperative equity issuance date means the date in which the holding period for purchased stock (excluding statutory minimum borrower stock and third-party stock) and allocated equities start:

(1) For allocated equities, the quarter-ending in which:

(i) The System institution's Board of Directors has passed a resolution declaring a patronage refund; and

(ii) The System institution has completed the applicable accounting treatment by segregating the new allocated equities from its unallocated retained earnings.

(iii) For purchased stock (excluding statutory minimum borrower stock and third-party stock), the quarter-ending in which the stock is acquired by the holder and recognized on the institution's balance sheet.

* * * * *

Eligible margin loan means:

(1) An extension of credit where:

(i) The extension of credit is collateralized exclusively by liquid and readily marketable debt or equity securities, or gold;

(ii) The collateral is marked-to-fair value daily, and the transaction is subject to daily margin maintenance requirements; and

(iii) The extension of credit is conducted under an agreement that provides the System institution the right to accelerate and terminate the extension of credit and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, conservatorship, or similar proceeding, of the counterparty, provided that, in any such case:

(A) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(1) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any

similar insolvency law applicable to GSEs,⁶⁰ or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (1)(iii)(A)(1) in order to facilitate the orderly resolution of the defaulting counterparty; or

(2) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (1)(iii)(A)(1) of this definition; and

(B) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of part 47, Subpart I of part 252 or part 382 of Title 12, as applicable.

⁶⁰ This requirement is met where all transactions under the agreement are (i) executed under U.S. law and (ii) constitute "securities contracts" under section 555 of the Bankruptcy Code (11 U.S.C. 555), qualified financial contracts under section 11(e)(8) of the Federal Deposit Insurance Act, or netting contracts between or among financial institutions under sections 401-407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve Board's Regulation EE (12 CFR part 231).

(2) In order to recognize an exposure as an eligible margin loan for purposes of this subpart, a System institution must comply with the requirements of § 628.3(b) with respect to that exposure.

* * * * *

Qualifying master netting agreement means a written, legally enforceable agreement provided that:

(1) The agreement creates a single legal obligation for all individual transactions covered by the agreement upon an event of default following any stay permitted by paragraph (2) of this definition, including upon an event of receivership, conservatorship, insolvency, liquidation, or similar proceeding, of the counterparty;

(2) The agreement provides the System institution the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, conservatorship, insolvency, liquidation, or

similar proceeding, of the counterparty,
provided that, in any such case:

(i) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(A) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (2) (i) (A) in order to facilitate the orderly resolution of the defaulting counterparty; or

(B) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (2) (i) (A) of this definition; and

(ii) The agreement may limit the right to accelerate, terminate, and close-out on a net basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the

extent necessary for the counterparty to comply with the requirements of part 47, Subpart I of part 252 or part 382 of Title 12, as applicable;

(3) The agreement does not contain a walkaway clause (that is, a provision that permits a non-defaulting counterparty to make a lower payment than it otherwise would make under the agreement, or no payment at all, to a defaulter or the estate of a defaulter, even if the defaulter or the estate of the defaulter is a net creditor under the agreement); and

(4) In order to recognize an agreement as a qualifying master netting agreement for purposes of this subpart, a System institution must comply with the requirements of § 628.3(d) with respect to that agreement.

* * * * *

Repo-style transaction means a repurchase or reverse repurchase transaction, or a securities borrowing or securities lending transaction, including a transaction in which the System institution acts as agent for a customer and indemnifies the customer against loss, provided that:

(1) The transaction is based solely on liquid and readily marketable securities, cash, or gold;

(2) The transaction is marked-to-fair value daily and subject to daily margin maintenance requirements;

(3) (i) The transaction is a "securities contract" or "repurchase agreement" under section 555 or 559, respectively, of the Bankruptcy Code (11 U.S.C. 555 or 559), a qualified financial contract under section 11(e) (8) of the Federal Deposit Insurance Act, or a netting contract between or among financial institutions under sections 401 - 407 of the Federal Deposit Insurance Corporation Improvement Act or the Federal Reserve's Regulation EE (12 CFR part 231); or

(ii) If the transaction does not meet the criteria set forth in paragraph (3) (i) of this definition, then either:

(A) The transaction is executed under an agreement that provides the System institution the right to accelerate, terminate, and close-out the transaction on a net basis and to

liquidate or set-off collateral promptly upon an event of default, including upon an event of receivership, insolvency, liquidation, or similar proceeding, of the counterparty, provided that, in any such case:

(1) Any exercise of rights under the agreement will not be stayed or avoided under applicable law in the relevant jurisdictions, other than:

(i) In receivership, conservatorship, or resolution under the Federal Deposit Insurance Act, Title II of the Dodd-Frank Act, or under any similar insolvency law applicable to GSEs, or laws of foreign jurisdictions that are substantially similar to the U.S. laws referenced in this paragraph (3)(ii)(A)(1)(i) in order to facilitate the orderly resolution of the defaulting counterparty;

(ii) Where the agreement is subject by its terms to, or incorporates, any of the laws referenced in paragraph (3)(ii)(A)(1)(i) of this definition; and

(2) The agreement may limit the right to accelerate, terminate, and close-out on a net

basis all transactions under the agreement and to liquidate or set-off collateral promptly upon an event of default of the counterparty to the extent necessary for the counterparty to comply with the requirements of part 47, Subpart I of part 252 or part 382 of Title 12, as applicable; or

(B) The transaction is:

(1) Either overnight or unconditionally cancelable at any time by the System institution; and

(2) Executed under an agreement that provides the System institution the right to accelerate, terminate, and close-out the transaction on a net basis and to liquidate or set-off collateral promptly upon an event of counterparty default; and

(4) In order to recognize an exposure as a repo-style transaction for purposes of this subpart, a System institution must comply with the requirements of § 628.3(e) of this part with respect to that exposure.

* * * * *

System institution means a System bank, an association of the Farm Credit System, and their successors, and any other institution chartered by the FCA that the FCA determines should be considered a System institution for the purposes of this subpart.

* * * * *

12. Amend § 628.10 by revising paragraph (c)(4) to read as follows:

§ 628.10 Minimum capital requirements.

* * * * *

(c) * * *

(4) *Tier 1 leverage ratio.* (i) A System institution's leverage ratio is the ratio of the institution's tier 1 capital to the institution's average total consolidated assets as reported on the institution's Call Report minus amounts deducted from tier 1 capital under §§ 628.22(a) and (c) and 628.23.

(ii) To calculate the measure of URE and URE equivalents described in § 628.10(b)(4), a System institution must deduct from URE and URE equivalents an amount equal to all the deductions required under § 628.22(a) and (c),

and must use the denominator of the tier 1 leverage ratio.

* * * * *

13. Amend § 628.20 by revising paragraphs (b) (1) (i) through (ii), (xiv), (c) (1) (xiv), (d) (1) (i), (1) (xi), and (f) (5) (ii).

The revisions read as follows:

§ 628.20 Capital components and eligibility criteria for tier 1 and tier 2 capital instruments.

* * * * *

(b) * * *

(1) * * *

(i) The instrument is paid-in, issued directly by the System institution, and represents the most subordinated claim in a receivership, insolvency, liquidation, or similar proceeding of the System institution;

(ii) The holder of the instrument is entitled to a claim on the residual assets of the System institution after all senior claims have been satisfied in a receivership, insolvency, liquidation, or similar proceeding;

* * * * *

(xiv) The System institution's capitalization bylaws, or a resolution adopted

by its board of directors under § 628.21, provides that the institution:

(A) Establishes a minimum redemption or revolvment period of 7 years for equities included in CET1; and

(B) Shall not redeem, revolve, cancel, or remove any equities included in CET1 without prior approval of the FCA under § 628.20(f), except that the minimum statutory borrower stock described in paragraph (b)(1)(x) of this section may be redeemed without a minimum period outstanding after issuance and without the prior approval of the FCA, as long as after the redemption, the System institution continues to comply with all minimum regulatory capital requirements.

* * * * *

(c) * * *

(1) * * *

(xiv) The System institution's capitalization bylaws, or a resolution adopted by its board of directors under § 628.21, provides that the institution:

(A) Establishes a minimum redemption or no-call period of 5 years for equities included in additional tier 1; and

(B) Shall not redeem, revolve, cancel, or remove any equities included in additional tier 1 capital without prior approval of the FCA under § 628.20(f).

* * * * *

(d) * * *

(1) * * *

(i) The instrument is issued and paid-in;

* * * * *

(xi) The System institution's capitalization bylaws, or a resolution adopted by its board of directors under § 628.21, provides that the institution:

(A) Establishes a minimum call, redemption or revolvment period of 5 years for equities included in tier 2 capital; and

(B) Shall not call, redeem, revolve, cancel, or remove any equities included in tier 2 capital without prior approval of the FCA under § 628.20(f).

* * * * *

(f) * * *

(5) * * *

(ii) After such cash payments have been declared and defined by resolution of the board, the dollar amount of the System institution's CET1 capital at quarter-end equals or exceeds the dollar amount of CET1 capital on the same quarter-end in the previous calendar year; and

* * * * *

14. Add new § 628.21 to read as follows:

§ 628.21 Capital bylaw or board resolution to include equities in tier 1 and tier 2 capital.

In order to include otherwise eligible purchased and allocated equities in tier 1 capital and tier 2 capital, the System institution must adopt a capitalization bylaw, or its board of directors must adopt a binding resolution, which resolution must be acknowledged by the board on an annual basis in the capital adequacy plan described in § 615.5200, in which the institution undertakes the following, as applicable:

(a) The institution shall obtain prior FCA approval under § 628.20(f) before:

(1) Redeeming or revolving the equities included in common equity tier 1 (CET1) capital;

(2) Redeeming or calling the equities included in additional tier 1 capital; and

(3) Redeeming, revolving, or calling instruments included in tier 2 capital other than limited life preferred stock or subordinated debt on the maturity date.

(b) The equities shall have a minimum redemption or revolvment period as follows:

(1) 7 years for equities included in CET1 capital, except that the minimum statutory borrower stock described in § 628.20(b)(1)(x) may be redeemed without a minimum holding period and that equities designated as unallocated retained earnings (URE) equivalents cannot be revolved without submitting a written request to the FCA for prior approval;

(2) A minimum no-call, repurchase, or redemption period of 5 years for additional tier 1 capital; and

(3) A minimum no-call, repurchase, redemption, or revolvment period of 5 years for tier 2 capital.

(c) The institution shall submit to FCA a written request for prior approval before:

(1) Redesignating URE equivalents as equities that the institution may exercise its discretion to redeem other than upon dissolution or liquidation;

(2) Removing equities or other instruments from CET1, additional tier 1, or tier 2 capital other than through repurchase, cancellation, redemption or revolvment; and

(3) Redesignating equities included in one component of regulatory capital (CET1 capital, additional tier 1 capital, or tier 2 capital) for inclusion in another component of regulatory capital.

(d) The institution shall not exercise its discretion to revolve URE equivalents except upon dissolution or liquidation and shall not offset URE equivalents against a loan in default except as required under final order of a court of competent jurisdiction or if required under § 615.5290 in connection with a restructuring under part 617 of this chapter.

(e) The minimum redemption and revolvment period (holding period) for purchased and allocated equities starts on the common cooperative equity issuance date, as defined in § 628.2.

15. Amend § 628.22 by revising paragraphs (a) (6) and (b) to read as follows:

§ 628.22 Regulatory capital adjustments and deductions.

* * * * *

(a) * * *

(6) The System institution's allocated equity investment in another System institution or service corporation; and

* * * * *

(b) *Regulatory adjustments to common equity tier 1 capital.* (1) Any accrual of a patronage or dividend payable or receivable recognized in the financial statements prior to a related board declaration resolution must be reversed to or from unallocated retained earnings for purposes of calculating common equity tier 1 capital.

* * * * *

16. Amend § 628.32 by revising paragraph (1) (1) to read as follows:

§ 628.32 General risk weights.

* * * * *

(1) *Other assets.* (1) A System institution must assign a 0-percent risk weight to cash owned and held in all offices of the System institution or in transit; to gold bullion held in the System institution's own vaults or held in a depository institution's vaults on an allocated basis, to the extent the gold bullion assets are offset by gold bullion liabilities; and to

exposures that arise from the settlement of cash transactions (such as equities, fixed income, spot foreign exchange (FX) and spot commodities) with a central counterparty where there is no assumption of ongoing counterparty credit risk by the central counterparty after settlement of the trade.

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17. Amend § 628.43 by revising paragraphs (d) (1) and (2) to read as follows:

§ 628.43 Simplified supervisory formula approach (SSFA) and the gross-up approach.

* * * * *

(d) * * *

(1) The System institution must define the following parameters:

$$K_A = (1 - W) \times K_G + (0.5 \times W)$$

(2) Then the System institution must calculate K_{SSFA} according to the following equation:

$$K_{SSFA} = \frac{e^{au} - e^{al}}{a(u - l)}$$

Where:

$$a = - \frac{1}{p \times K_A},$$

$$u = D - K_A,$$

$$l = \max(A - K_A, 0), \text{ and}$$

$$e = 2.71828, \text{ the base of the natural logarithm}$$

* * * * *

18. Amend § 628.52 by revising paragraph

(c)(2)(ii) to read as follows:

§ 628.52 Simple risk-weight approach (SRWA).

* * * * *

(c) * * *

(2) * * *

(ii) Under the variability-reduction method of measuring effectiveness:

$$E = 1 - \frac{\sum_{t=1}^T (X_t - X_{t-1})^2}{\sum_{t=1}^T (A_t - A_{t-1})^2}$$

Where:

$$\underline{X_t} = A_t - B_t;$$

A_t = the value at time t of one exposure in a hedge pair; and

B_t = the value at time t of the other exposure in a hedge pair.

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19. Amend § 628.63 by:

- a. Removing and reserving paragraph (b) (3);
- b. Revising paragraph (b) (4) .

The revision reads as follows:

§ 628.63 Disclosures.

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(b) * * *

(3) [Reserved]

(4) A reconciliation of regulatory capital elements using both month-end and average daily balances as they relate to its balance sheet in any applicable audited consolidated financial statements.

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Dated: July 21, 2020

Dale Aultman, Secretary,
Farm Credit Administration Board.

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